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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. .....

G. HAROLD EARLE and STEWART E. EARLE, Former Executors of the Estate of Emma Earle, Deceased, and Residuary Beneficiaries of Said Estate, *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

The petitioners, G. Harold Earle and Stewart E. Earle, former executors of the estate of Emma Earle, deceased, and residuary beneficiaries of said estate, pray that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit entered in the above entitled cause on October 23, 1946.

OPINIONS BELOW.

The opinion of The Tax Court of the United States (R. 17-34) is reported at 5 T. C. 991. The opinion of the Circuit Court of Appeals (R. 88-90) is reported at 157 F. 2d 501.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on October 23, 1946 (R. 87). The jurisdiction of this Court is invoked under § 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Where a trust estate is terminated and distribution made by a state court in accordance with the terms of the trust instrument, and such action is uncontested and becomes final, may the federal government set aside the state court decree, reassign the distributions of income made by the state court, treat the corpus of the trust party as income, and assert a tax against an estate on such reassigned property (or income) which never became an asset of the estate in question under the decree of the state court terminating the trust estate and assigning the residue?

STATUTE INVOLVED.

The statute involved is § 811(a) of the Internal Revenue Code which defines a decedent's gross estate as follows:

SEC. 811. GROSS ESTATE.

> The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—
>
> (a) DECEDENT'S INTEREST.—To the extent of the interest therein of the decedent at the time of his death;
> * * *

STATEMENT OF THE CASE.

George W. Earle died on October 10, 1923, and his will was admitted to probate on November 27, 1923, by the Probate Court of Menominee County, Michigan (R. 19-20, 57). The will provided in part as follows (R. 20-21, 57-60):

After the payment of my just debts, liabilities and funeral expenses, I give, devise and bequeath *all* of my estate, both real and personal and wherever situate, unto G. Harold Earle, Stewart Earle and Charles M. Case, as trustees, and the survivor of them and his successor thereto, and his heirs, executors and administrators, respectively, according to the nature thereof, upon trust, to sell, convey or mortgage such parts of the trust property upon such terms as they may deem advisable, *and to invest the proceeds thereof, or any moneys belonging to said trust estate, in such securities or in the carrying on of any business* in which I may be interested at the time of my death, or to engage in any other business or enterprise of any nature whatsoever, as they may from time to time deem advantageous, with power to employ at such salaries as they shall think fit, such persons as may be necessary to carry on such business or enterprises, *and generally to act in all matters relating thereto as if they were beneficially entitled to the same.*

* * * * * *

I further direct that *the income accruing to said trust estate shall be distributed at such times and in such amounts as said trustees shall deem best; said income to be paid to my wife, Emma Earle, one-third, to G. Harold Earle, his heirs, executors or administrators, one-third, and to Stewart Earle, his heirs, executors or administrators, one-third.*

Said trust to continue until the death of my said wife, Emma Earle, at which time said trust estate shall be closed and divided equally between my sons, G. Harold Earle and Stewart Earle. (Italics supplied.)

* * * * * *

The will also nominated Harold and Stewart Earle as executors, and they were appointed, qualified, and served as such until the administration of the estate was concluded on August 16, 1926 (R. 21). At that time, after due notice, they were discharged as executors, and the residue of the estate, consisting of both real and personal property, was transferred as corpus to them and to Charles M. Case as trustees of the testamentary trust provided for in the will

(R. 21-22, 47, 68-75). The attorney who drew the will (R. 43) represented the executors when the estate was transferred as corpus to the trustees (R. 69).

The order of the Probate Court read in part as follows:

> This day having been appointed for hearing the petition of G. Harold Earle and Stewart Earle, executors of said estate, praying that the residue of said estate be assigned to G. Harold Earle, Stewart Earle and Charles M. Case, as trustees under the Will and as sole devisees and legatees of said deceased, *and due notice of the hearing on said petition having been given as directed by said court,* the said petitioners appeared by G. R. Empson, their attorney.
>
> It appearing to the court that all debts, funeral charges, expenses of administration, and *all allowances for the maintenance of the family of said deceased,* and for the support of the children under seven years, have been fully paid; that the widow's *preferred claims to the personal estate have been fully satisfied;* that all proceedings required by law for the proper administration and settlement of said estate have been taken, and that there remains to be assigned to the said G. Harold Earle, Stewart Earle, and Charles M. Case, as trustees, *sole devisees and legatees of said estate,* a residue of the real estate of the value * * * ($26,255.81) and personal estate of the value of * * * ($2,082,793.20) which said real estate and personal property is described as follows, to wit:
>
> * * * * * *
>
> It further appearing that G. Harold Earle, Stewart Earle and Charles M. Case, as trustees, *are the sole devisees and legatees of said estate,*
>
> It is ordered that such residue, all of the personal property of every kind and nature and all of the real estate in fee simple, of which deceased died seized, be and the same is hereby assigned to the said G. Harold Earle, Stewart Earle and Charles M. Case, as trustees, and their successors, according to the last Will and Testament of the said deceased. (R. 69, 75; italics supplied.)

During the administration of this testamentary trust the trustees accumulated part of the income of the trust, believing that the will granted them discretion to do so and that they were carrying out the testator's intent. They reinvested a large part of the accumulated income. They were never criticized for their acts in administering the trust. Whenever cash distributions were made to Emma Earle, like amounts were distributed to Harold and Stewart. (R. 22-23, 46, 53-54, 57.) These distributions were discontinued when Emma Earle notified the trustees that she did not want any further amounts distributed to her (R. 24, 53, 56-57).

After her husband's death Emma Earle continued to live in the large home which she owned in Hermansville. She traveled extensively and had her own car, chauffeur, and household servants (R. 23, 44). She owned stock in the Wisconsin Land and Lumber Company on which she received substantial dividends and she received interest on her savings (R. 24, 46-47, 61-68). During the period from her husband's death in 1923 until her death in 1940 she accumulated over $92,000 in savings (R. 24, 55, 61-68). Her only heirs at law were her two sons, G. Harold Earle and Stewart E. Earle, who were also two of the trustees of the said trust (R. 19-20).

Emma Earle died November 1, 1940, a resident of Hermansville, Michigan. She left a will under which her two sons, the petitioners, were appointed executors of her estate. They filed an estate tax return with the collector for the district of Michigan and paid the tax shown therein to be due. Thereafter they distributed to themselves as residuary beneficiaries the corpus of her estate remaining after the payment of debts, expenses, etc. (R. 19.)

Following the death of Emma Earle the testamentary trust of George W. Earle was also closed and the assets then on hand were distributed to petitioners as the residuary beneficiaries of the trust. This distribution was ordered by the probate court in a final decree which recited that

G. Harold Earle and Stewart E. Earle were "* * * the only persons interested in said estate * * *" (R. 76-83).

The respondent subsequently determined a deficiency in estate tax against the estate of Emma Earle by including as corpus of her estate one-third of the undistributed income of the estate of George W. Earle and of the trust created by George W. Earle (R. 11-13). On an appeal from this determination the Tax Court affirmed in principle the action of respondent (R. 17-34) as did the Circuit Court of Appeals (R. 87-90).

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court erred:

1. In holding that the income of the estate of George W. Earle, deceased, was distributable and that the undistributed portion thereof did not become part of the testamentary trust corpus, as decreed by the state court.

2. In holding that all of the undistributed income of the trust should have been distributed (one-third to Emma Earle), contrary to the state court decree.

3. In failing to find and hold that the trustees under the will of George W. Earle were granted discretion with regard to the distribution of the income accruing to the testamentary trust.

4. In failing to follow the state court decrees terminating the said estate of George W. Earle and the said residuary trust estate.

REASONS FOR GRANTING THE WRIT.

1. The opinion below followed *Commissioner* v. *Child's Estate*, 3 Cir., 147 F. 2d 368, in holding that an otherwise controlling state court decree would not be followed when it was entered in an uncontested proceeding. Both the cited case and the decision below are in direct conflict

with *Henricksen* v. *Baker-Boyer National Bank*, 9 Cir., 139 F. 2d 877, 881; *Frederich* v. *Commissioner*, 5 Cir., 145 F. 2d 796, 798; and *Eisenmenger* v. *Commissioner*, 8 Cir., 145 F. 2d 103, 107; where uncontested state court decrees were held to be controlling for federal tax purposes.

In *Blair* v. *Commissioner*, 300 U. S. 5, and *Sharp* v. *Commissioner*, 303 U. S. 624, cited below (R. 89), this Court held that the state court decrees in litigated cases were controlling as to the interests or rights actually owned by the subject sought to be taxed. The decision below grafts an exception on this ruling in all instances where the parties are in agreement as to the proper devolution of property under state law, and there is, therefore, no contest in the state courts. The efficacy of state court decrees in such cases is a matter of recurring importance in federal tax litigation, and the conflict between the Circuit Courts considering this question should be settled by this Court.

2. The Circuit Court in its opinion held that—

> * * * the interest of a decedent under a will may be liable for an estate tax even though the property has never been received (R. 89).

If this language implies (as it must here) that a decedent's estate can be taxed on property which the decedent never actually received and which under final state court decrees the decedent's estate *never will actually receive*, it is submitted that the scope of the ruling below is so broad as to warrant review by this Court.

In the lower court petitioners contended that the estate should not be taxed on property which neither the decedent nor the estate ever received. The argument was brushed aside as "academic" on the ground that the petitioners individually received the money here involved from their father's estate if not from their mother's (R. 89). But if they inherited the amount involved from their father, or through a trust created by him in his will, it certainly could not have been an asset of their mother's estate so as to be taxable to her estate.

3. The decision below in permitting estate income to retain its identity when transferred to a testamentary trust as corpus of the trust (R. 68-75) conflicts with *Weigel* v. *Commissioner*, 7 Cir. 96 F. 2d 387, 389, where in an income tax case the Circuit Court held:

> * * * in the case of the creation of a testamentary trust out of the residue of an estate, the residue consisting of estate corpus and estate income, the reality, both factually and legally, is that estate income has ceased to have any identity. And it would seem to follow that *fiduciaries who take the residue as the res of a testamentary trust receive it as trust corpus* and not as a payment, in whole or in part, of estate income. (Italics supplied.)

CONCLUSION.

It is respectfully submitted that the tax effect of state court decrees in uncontested proceedings presents an important question of federal law with respect to which the Circuit Courts of Appeal are not in accord and that this petition for a writ of certiorari should be granted to resolve the conflict.

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